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In the Supreme Court of the United States

OCTOBER TERM, 1965

No.

UNITED STATES OF AMERICA, PETITIONER

v.

JEROME KALISHMAN, TRUSTEE IN BANKRUPTCY OF SEYMOUR WALLAS AND COMPANY, BANKRUPT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The district court rendered no opinion. The opinion of the court of appeals (Appendix A, *infra*, pp. 9–20) is reported at 346 F. 2d 514.

JURISDICTION

The judgment of the court of appeals was entered on June 4, 1965 (App. A, *infra*, p. 20). On August 26, 1965, Mr. Justice White extended the time for filing a petition for a writ of certiorari to and including November 1, 1965. The jurisdiction of this

Court is invoked under 28 U.S.C. 1254(1) and Section 24c of the Bankruptcy Act.

QUESTION PRESENTED

A debtor in possession operating its business during an arrangement proceeding under Chapter XI of the Bankruptcy Act incurred liability for withheld income taxes on its employees' salaries. The taxes did not become due until after the debtor was adjudicated a bankrupt; the trustee in bankruptcy did not timely pay them. The question presented is whether the trustee is liable for interest on the unpaid taxes to the date of payment.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Bankruptcy Act, the Internal Revenue Code of 1954, Title 28 of the United States Code, and Treasury Regulations on Income Tax (1954 Code) are set forth in Appendix B, *infra*, pp. 21–28.

STATEMENT

Seymour Wallas and Company, a corporation, filed a petition for an arrangement under Chapter XI of the Bankruptcy Act on June 24, 1960. Having failed to submit an acceptable plan, the company was adjudicated a bankrupt on March 16, 1961. During the arrangement proceedings the debtor in possession operated the business, and in the first quarter of 1961 it withheld taxes of $6,602.89 on its employees' salaries. These taxes were not due until April 30, 1961, which was subsequent to the adjudication in bankruptcy. The trustee in bankruptcy, however,

failed to file the required quarterly return and to pay the taxes. On November 3, 1961, the government filed in the bankruptcy proceeding a claim for the principal amount of the taxes plus interest until they were paid.[1] R. 3–4, 23–24; App. A, *infra*, pp. 9–10. The referee in bankruptcy allowed the government's claim for taxes but disallowed the claim for interest (R. 22–28),[2] and the district court (R. 32) and the court of appeals affirmed (App. A, *infra*, pp. 9–20).

The court of appeals ruled, as both parties had agreed, that the principal amount of the taxes was properly allowable as an expense of administration, entitled to first priority in payment under Section 64(a) of the Bankruptcy Act (11 U.S.C. 104(a)) (App. A, *infra*, p. 11). But it held (*id.* at 18) that, "[i]n light of the policy enunciated" in *New York* v. *Saper*, 336 U.S. 328, against the allowance of post-bankruptcy interest, the referee properly had denied interest.

REASONS FOR GRANTING THE WRIT

1. The holding of the court of appeals that the United States is not entitled to interest on the taxes that a debtor in possession incurred during a Chapter XI proceeding but which were not due until after bankruptcy occurred, is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in *United States* v. *Nicholas*, 346 F. 2d 32, pending

[1] The principal amount of the taxes was paid on May 6, 1964, and the accrued interest involved is $1,172.28 (App. A, *infra*, p. 10).

[2] "R." refers to the printed record in the court of appeals.

on petition for certiorari, No. 650, this Term.[3] In the *Nicholas* case, as in the present case, a debtor in possession who operated its business during a Chapter XI proceeding became liable for taxes which it withheld from his employees' wages, but the taxes had not become due until the debtor was adjudicated a bankrupt. The Fifth Circuit ruled that the government was entitled to receive as first priority administration expenses, not only the principal amount of the taxes but also interest (and penalties) thereon to the date of payment. The court pointed out (App. C, *infra*, p. 33) "it is plain that the obligation of the obligation of the trustee here was the same as if he had been in possession from the filing of the original [Chapter] XI proceeding," and that the trustee therefore "is liable to the same obligation to make required returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face."

2. We submit that the court of appeals below erred in rejecting the government's claim for interest. The *Saper* case, upon which the court relied, is plainly distinguishable. *Saper* held only that where a tax liability arose before bankruptcy—*i.e.*, when it was the bankrupt himself rather than the trustee who incurred the liability—the claim did not bear interest for the period between bankruptcy and payment. The present case, however, brings into play Section 378(2) of the Bankruptcy Act (App. B, *infra*, pp. 23–24), which provides that a bankruptcy proceeding fol-

[3] The Fifth Circuit's opinion in *Nicholas* is set forth in Appendix C, *infra*, pp. 29–33.

lowing an unsuccessful Chapter XI proceeding is to be conducted "so far as possible, in the same manner and with like effect as if" a voluntary petition in bankruptcy had been filed and there had been an adjudication of bankruptcy on the day on which the Chapter XI petition was filed. Thus, as the court of appeals pointed out in the *Nicholas* case (App. C, *infra*, p. 33) "it is plain that the obligation of the trustee here was the same as if he had been in possession from the filing of the original [Chapter] XI proceeding."

The pertinent authority, therefore, is not *Saper* but, as the *Nicholas* case held (*ibid.*), *Boteler* v. *Ingels*, 308 U.S. 57. There this Court held that a bankrupt's estate was liable for penalties imposed by State law for non-payment of automobile license fees that a trustee in bankruptcy incurred during operations for the purpose of liquidating the bankrupt's business. The Court ruled (pp. 59–60) that the prohibition in Section 57j of the Bankruptcy Act (11 U.S.C. 93(j)) against the allowance of tax penalties arising prior to bankruptcy was inapplicable, because it applies only if the penalty is "incurred by the bankrupt before bankruptcy by reason of his own delinquency," and there the "fees and penalties at issue were incurred by the trustee in operating the bankrupt business * * *." Since in the present case the trustee is treated as though he took office when the Chapter XI petition was filed, the taxes similarly were "incurred by the trustee in operating the bankrupt business." The court below correctly acknowledged that such taxes were a proper

administration expense of the bankrupt estate, but failed to recognize that because taxes carry interest until paid, the interest also constituted an expense of administration.[4] See *Bruning* v. *United States*, 376 U.S. 358; see also, 28 U.S.C. 960 (App. B, *infra*, p. 24).

3. The issue is of "considerable practical importance in the administration of the Bankruptcy Act"[5] and this Court therefore should resolve the conflict. The question of the government's right to interest on taxes which the debtor incurs while operating his business in the period between the filing of the Chapter XI petition and the adjudication in bankruptcy is likely to arise in a large percentage of the cases in which bankruptcy follows an unsuccessful Chapter XI proceeding. The following table shows that there

---

[4] The government's claim to priority in payment of the taxes themselves—a priority which we believe also covers interest—may also be supported by Section 7501 of the Internal Revenue Code (App. B, *infra*, p. 26). The trustee is required to withhold taxes on his employees' wages and to pay them over to the United States. Section 7501 provides that the amount of taxes thus collected "shall be held to be a special fund in trust for the United States." As an officer of the court, the trustee in bankruptcy was obligated to perform that statutory obligation by turning over the trust fund to the United States as soon as the withheld taxes were due; and thus the United States is entitled to the funds wholly apart from its claim thereto as an administration expense. Cf. *City of New York* v. *Rassner*, 127 F. 2d 703, 706 (C.A. 2), and *In re Airline-Arista Printing Corp.*, 156 F. Supp. 403 (S.D. N.Y.), affirmed *per curiam*, 267 F. 2d 333 (C.A. 2).

[5] *New York* v. *Saper*, 336 U.S. 328, 329.

is a substantial number of such cases which has been increasing in recent years:

Fiscal year ended June 30	Chapter XI proceedings filed	Chapter XI proceedings in which debtor adjudicated bankrupt
1961	947	370
1962	903	412
1963	1,188	485
1964	1,088	604

(Tables of Bankruptcy Statistics, published by the Administrative Office of the United States Courts, for the fiscal years ending June 30, 1961, through 1964, Tables F2 and F4b, and for the fiscal year ending June 30, 1964, pp. 4 and 5.)

Although the issue has not hitherto caused much litigation, this is not a fair indication of its importance. The decision below—the first appellate ruling denying the government's claim to interest in these circumstances—is hardly likely to pass unnoticed by the bankruptcy bar, and it will almost certainly encourage trustees in bankruptcy to oppose such claims. Although most of these claims involve small amounts, their annual total is substantial. Even more important is the fact that, as long as the conflict between the circuits remains, there is likely to be a heavy volume of litigation on the issue. Thus, unless the government were to abandon pressing its claims for interest—and, as shown above, we have sound grounds for believing that our claims are valid—it would be required to conduct extensive litigation on this narrow issue. In the circumstances, it is appropriate for this Court to decide the question and eliminate the uncertainty which the conflict between the circuits has created.

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CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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NOVEMBER, 1965.

APPENDIX A

United States Court of Appeals for the Eighth Circuit

No. 17780

UNITED STATES OF AMERICA, APPELLANT

v.

JEROME KALISHMAN, TRUSTEE IN BANKRUPTCY OF SEYMOUR WALLAS AND COMPANY, BANKRUPT, APPELLEE

Appeal from the United States District Court for the Eastern District of Missouri

(June 4, 1965)

Before VOGEL, MATTHES and RIDGE, Circuit Judges

RIDGE, *Circuit Judge*: The sole question presented by this appeal is whether the United States is entitled to interest until date of payment of withholding taxes which accrued against the debtor while in possession of the business under an arrangement proceeding, and the interest did not begin to run on the tax until after the final adjudication in bankruptcy. Despite this simple statement of the problem here confronting us, the present case requires an exhaustive analysis of the present state of the law regarding post-bankruptcy interest claims. As appellee admits that "Appellant's statement of the case is essentially correct," the following facts are culled therefrom.

Seymour Wallas and Company, a corporation, filed a petition for an "arrangement" on June 24, 1960. Thereafter, it was adjudicated a bankrupt on March 16, 1961, having failed to submit an acceptable plan.

On September 15, 1961, the United States filed a claim for taxes, separated into two claims—one for taxes accruing before the arrangement proceeding,—the other for taxes accruing during the arrangement. The latter claim is the only one in issue here. It was for assessed withholding taxes of $6,602.89 for the first quarter of 1961, plus $202.38 interest to the date of filing the claim, and interest of $1.06 per day thereafter until payment of the principal was made—ultimately on May 6, 1964. These taxes were not required to be reported or paid until April 30, 1961, subsequent to the adjudication in bankruptcy after failure of the arrangement proceeding; hence the interest here did not begin to accrue until that date. The Referee allowed the tax claim in the principal amount of $6,602.89 as an expense of administration of the arrangement proceeding but denied the claim for interest, basing his decision on *City of New York* v. *Saper,* 336 U.S. 328, 69 S. Ct. 554, 93 L. Ed. 710 (1949). On petition for review, the District Court affirmed in an unreported order. This appeal followed.

At the outset we are met with a jurisdictional question, raised by appellee in view of § 24(a) of the Act,[1] which limits appeals in bankruptcy proceedings to matters involving more than $500.00 unless prior allowance of the appeal has been granted by the Court of Appeals. (See Rule 25 of this Court, 28 U.S.C.A., Rules, 8 Cir.) Since appellant claims interest to date of payment, it is readily apparent that substantially more than $500.00 is in issue here, even though the amount claimed was less than that sum at the time of filing the claim.[2] Regardless, this is an appeal

[1] 11 U.S.C.A. § 47(a).

[2] The accrued interest now claimed by the Government amounts to $1,172.28.

which we can, and should, hear in our discretion, in the interest of substantial justice. *R.F.C.* v. *Prudence Group*, 311 U.S. 579, 61 S. Ct. 331, 85 L. Ed. 364 (1941); *New York Credit Men's Adjustment Bureau, Inc.* v. *Strauss & Co.*, 296 F. 2d 702 (2 Cir., 1961). It is of sufficient importance to the future administration of the Bankruptcy Act (hereinafter denominated Act) to warrant our consideration thereof on its merits. *State of California* v. *Renauld & Co.*, 179 F. 2d 605 (9 Cir., 1950).

Neither party questions the allowance of the principal amount of the taxes here considered as a proper expense of administration of the arrangement proceeding, entitled to a first priority under § 64(a)[3] of the Act. They are taxes incurred while the property of the debtor was *in custodia legis* under the administration of the bankruptcy court, and thus are clearly expenses of administration as that term has long been understood. Cf. *Dayton* v. *Stanard*, 241 U.S. 588, 36 S. Ct. 695, 60 L. Ed. 1190 (1916); *State of Missouri* v. *Gleick*, 135 F. 2d 134 (8 Cir., 1943); *United States* v. *Sampsell*, 266 F. 2d 631 (9 Cir., 1959). See also, 3 Collier on Bankruptcy § 64.105, p. 2088. It is appellant's contention that since under normal circumstances interest on unpaid taxes is considered an integral part of a tax liability itself, the interest here in issue should equally share that preferred status unless the fact of bankruptcy on the part of the taxpayer requires a different result.

In bankruptcy matters the Bankruptcy Act takes precedence over other statutes, and governs in any case where there might be conflict. *Guarantee Title & T. Co.* v. *Title Guaranty & S. Co.*, 224 U.S. 152, 32 S.

[3] 11 U.S.C.A., § 104(a).

Ct. 457, 56 L. Ed. 706 (1912); *Adams* v. *O'Malley*, 182 F. 2d 925 (8 Cir., 1950); *United States* v. *Wood*, 290 Fed. 109 (2 Cir., 1923), aff'd 263 U.S. 680, 44 S. Ct. 133, 68 L. Ed. 503. Thus, in the matter of priorities the courts are bound by the terms of the Act, regardless of other statutory preferences. *Missouri* v. *Ross*, 299 U.S. 72, 57 S. Ct. 60, 81 L. Ed. 46 (1936); *Davis* v. *Pringle*, 268 U.S. 315, 45 S. Ct. 549, 69 L. Ed. 974 (1925). Present § 64(a) of the Act, *supra*, represents a clear departure from pre-Chandler Act practice, in that it reduces all costs and expenses of administration to a parity; that is, taxes no longer have a special priority over any other expenses of administration, all of which now share the same priority on an equal basis. *Missouri* v. *Earhart*, 111 F. 2d 992 (8 Cir., 1940); *In re Columbia Ribbon Co.*, 117 F. 2d 999 (3 Cir., 1941). Therefore, our consideration of post-bankruptcy interest in this tax claim can be no different than that of interest accruing generally as cost of administration on other like claims.

Considering interest in connection with bankruptcy, it appears that there is a "* * * long-standing rule against post-bankruptcy interest * * * implicit in our current Bankruptcy Act." *New York* v. *Saper*, l.c. 332. In *Vanston Committee* v. *Green*, 329 U.S. 156, l.c. 163, 67 S. Ct. 237, 91 L. Ed. 162 (1946), the Court stated: "The general rule in bankruptcy * * * has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings." As said in *Bruning* v. *United States*, 376 U.S. 358, at 361–362: "As to claims against the trustee in bankruptcy, the general rule for liquidation of the bankruptcy estate has long been that a creditor will be allowed interest only to the date of the petition in bankruptcy * * *" and that *Saper, supra*, makes the

general rule (applicable) "to claims against the trustee for taxes as well as for other debts." As the Court, in *Vanston Committee* v. *Green,* pointed out, this is a matter of equity * * * the delay in distribution being caused by law, and the estate should not be penalized for the delay by additional interest. In this connection, see *Sexton* v. *Dreyfus,* 219 U.S. 339, 31 S. Ct. 256, 55 L. Ed. 244 (1911); *United States* v. *Bass,* 271 F. 2d 129 (9 Cir., 1959); *Massachusetts* v. *Thompson,* 190 F. 2d 10 (1 Cir., 1951); 3 Collier on Bankruptcy, § 63.16, p. 1858. There is also a matter of administrative convenience, as the very purpose of a "cutoff" or "bar" date would be thwarted if obligations are allowed to accrue past that date, continuing the vicious circle which bankruptcy was designed to terminate. This is not to say that such post-bankruptcy interest may never be allowed, for it is settled that the creditors' rights thereto will be recognized should the estate subsequently prove to be solvent, or should the estate itself subsequently receive income in the form of interest. *United States* v. *Harrington,* 269 F. 2d 719 (4 Cir., 1959). We realize that the foregoing cases deal with interest which began to accrue prior to bankruptcy, on debts likewise accruing. Be that as it may, we think the broad policy and reasons therefor, toward post-bankruptcy interest, should be kept in mind in the consideration of the specific issue in question here.

In the instant case we deal with a debt incurred as an expense of administration by a debtor in possession, the interest on which did not begin to accrue until after a subsequent adjudication in bankruptcy. By virtue of § 378(2)[4] of the Act, the abortive arrange-

[4] 11 U.S.C.A., § 778(2).

ment proceeding and the subsequent bankruptcy are considered parts of a single proceeding so far as possible, and we must not consider the debt here incurred by the debtor in possession as though it were contracted by the trustee during bankruptcy.

There is no question, of course, that a trustee is liable for taxes incurred during the administration of the estate, whether resulting from continuing to do business, or simple ad valorem taxes on the property in the estate. *Boteler* v. *Ingels,* 308 U.S. 57, 60 S. Ct. 29, 84 L. Ed. 78 (1939); *In re Chicago & N.W. Ry. Co.,* 119 F. 2d 971 (7 Cir., 1941); *State of Missouri* v. *Earhart, supra.* Here, the question very simply is whether the Government is entitled to interest on such taxes after straight bankruptcy has been adjudicated until the date of payment of the taxes accruing during a prior arrangement proceeding.

In 1949, the Supreme Court handed down the decision in *City of New York* v. *Saper, Supra.* Since that time, the *Saper* decision has been variously considered in lower federal courts on numerous occasions. Such cases, of which the present is apparently the latest, involved the contention that the very broad language of *Saper* should be restricted to the specific situation involved there, but it should be noted that in each case thereafter the courts have taken the language of *Saper* at face value and accepted the rationale thereof, wherever logically required to do so. See, for example, *United States* v. *General Engineering & Mfg. Co.,* 188 F. 2d 80 (8 Cir., 1951), aff'd 342 U.S. 912, 72 S. Ct. 357, 96 L. Ed. 682; *United States* v. *Edens,* 189 F. 2d 876 (4 Cir., 1951), aff'd 342 U.S. 912; *State of New York* v. *Feinberg,* 204 F. 2d 502 (2 Cir., 1953).

The *Saper* case involved the question of post-bankruptcy interest on taxes accruing prior to straight bankruptcy. The Court, in denying such interest, noted that prior to the Chandler Act, interest was commonly allowed, based on the especially preferred status of taxes under the Act of 1898, and further, that lower federal courts had continued to do so even after the Chandler Act. However, in *Saper* it clearly held such practice to be in error, as being in violation of the long-standing bankruptcy tradition that accrual of interest against the estate ceases on the inception of bankruptcy as a matter of equity and practicality. Each of the cases subsequently considering *Saper* have likewise been concerned with straight pre-bankruptcy tax debts, and we are not cited to, nor have we found any subsequent cases specifically dealing with an issue situation such as here present. We think it necessary to remember, however, that the Court in *Saper* considered with favor the "long-standing rule" against post-bankruptcy interest based on equitable considerations.

Appellant asserts that *Boteler* v. *Ingels, supra,* is authority for allowance of the interest attempted to be collected here. In that case the Court held that a trustee in bankruptcy was liable for state penalties imposed for nonpayment of automobile license fees when the fees and penalties accrued during the operation of the business by the trustees for purposes of liquidation. We are also referred to *In re Chicago & N.W. Ry. Co., supra,* holding, on the authority of *Boteler,* an estate in bankruptcy was liable for the penalties on overdue state taxes accruing after the institution of the bankruptcy proceedings. Both of the above cases were mainly premised on the pro-

visions of the predecessor statute of 28 U.S.C.A., § 960, which provided generally the same as present § 960.[5] The reasoning of the Court in the above-cited cases was that § 57(j)[6] was applicable only to penalties incurred by the bankrupt individually prior to bankruptcy, and that it was not applicable to penalties brought on by the action of the trustee himself. In such instance, the provisions of § 960 of Title 28 were held to prevail. Without speculating as to the "intent" of the Supreme Court in *Saper* (which opinion did not mention *Boteler*), we believe the present case to be distinguishable from *Boteler,* and to come under the reasoning laid down in *Saper* without doing violence to *Boteler.* Our understanding of *Boteler* is that it holds simply that a trustee operating a business is subject to tax statutes, the same as any other citizen, and subject to penalties if he does not comply with the law. Such is not the issue in the present case.

Here, we deal with "interest" after adjudication, within the concept of "* * * compensation for the use or forbearance of money." *Deputy* v. *duPont,* 308 U.S. 488, 498, 60 S. Ct. 363, 84 L. Ed. 416 (1940); *C.I.R.* v. *Meyer,* 139 F. 2d 256 (6 Cir., 1943). *Boteler* deals with a "penalty" as punishment for wrongdoing. *United States* v. *Chouteau,* 102 U.S. 603, 26 L. Ed. 246 (1881); *Unemployment Reserves Commission* v. *Meilink,* 116 F. 2d 330 (9 Cir., 1940). The long-

[5] "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation." 28 U.S.C.A. § 960.

[6] 11 U.S.C.A., § 93(j).

standing rule followed in *Saper* is concerned with interest after adjudication, not penalties as accrued in *Boteler*. Certainly, no argument can be made that malfeasance by a trustee in bankruptcy is never to be allowed pecuniary reimbursement in a bankrupt estate, to the extent of actual loss caused thereby, if the trustee undertakes to act contrary to law. This is what is ruled in *Boteler*. Here, appellant's claim is wholly related to the concept of interest (i.e. reimbursement for the use of money), which interest commenced to run after the date of adjudication in bankruptcy. True, the statute *supra* gives taxes a priority * * * and they are to be paid as soon as possible * * *. If not so paid in a straight bankruptcy proceeding, any delay therefor can only be traced as caused by the law, not by the bankruptcy estate. This is the important distinction we find in the facts here. Paying taxes at the normal distribution time for debts of like priority, as ordered by the Court, creates quite a different situation than the affirmative violation of operating motor vehicles on the highways of a state without paying the necessary state motor vehicles license taxes.

Bruning v. *United States, supra,* does not require a *contra* ruling. There, interest on tax claims for the period from the filing of a petition in bankruptcy to the date of payment of the principal tax claim was recovered by the Government out of assets personally acquired by the tax debtor *after* his adjudication of bankruptcy, in the light of § 6873(a) of the Internal Revenue Code of 1954 (26 U.S.C.A. § 6873(a)). The facts and applicable law in *Bruning* do not militate against the ruling made in *Saper*. As the Court points up in *Bruning*, that "case concerns the debtor's personal liability for post-petition interest on a debt for taxes which survives bankruptcy to the extent that

(the tax) is not paid out of the estate." (Par. added.) 376 U.S., l.c. 362. Here, we are concerned with pro rata distribution of assets of a bankrupt's estate among preferred creditors, having equal priority as required by § 64(a) of the Bankrupt Act, *supra.*

Appellant's argument that this interest should be enforced because of the trustee's willful refusal to pay the tax immediately when due, is without merit. The Government, as a creditor in bankruptcy, occupies no favored position over other creditors of like priority. *State of Missouri* v. *Earhart; supra.* There is nothing in this record to suggest that the tax in question was not given the same consideration as other costs of administration which occupied the same priority. To allow this interest would be in effect to charge the estate with interest, because the trustee complied with the terms of the Bankruptcy Act and refused to give the taxes a special priority not sanctioned by the Act. Allowing this interest would be to place the trustee in the unenviable position of being forced to choose between his responsibility to conserve the estate, and creating a new priority for taxes, or strictly abiding by the statutory scheme for the payment of all debts of equal priority in bankruptcy estates.

Whether the tax accrued before bankruptcy or subsequent thereto, the evil propagated by continually accruing interest remains the same. In neither case is it logical to charge a bankrupt estate a fee for the use of money when it is the force of law which prevents the return of the principal to the creditor, rather than the desire of the debtor to retain its use. In light of the policy enunciated in *Saper,* we believe the referee was correct in denying interest on this tax claim. *Collectibility of Post-Bankruptcy Interest,*

by Max Schwartz, Vol. 36, No. 2, p. 49, Jour. Nat'l Ass'n of Referees in Bankr.

In the alternative, the Government asserts that by virtue of § 7501(a)[7] of the Internal Revenue Code of 1954, the principal amount of the tax here withheld, and the interest thereon, constitute a trust fund in the hands of the trustee to which the United States as *cestui* has an absolute right, independent of any questions of priority, citing: *City of New York* v. *Rassner,* 127 F. 2d 703 (2 Cir., 1942), construing a city ordinance making the vendor a trustee when collecting city sales tax from vendees; and *United States* v. *Sampsell,* 193 F. 2d 154 (9 Cir., 1951), construing the predecessor statute of present § 7501(a), *supra; Hercules Service Parts Corp.* v. *United States,* 202 F. 2d 938 (6 Cir., 1953), as to withholding tax; and *In re Airline-Arista Printing Corp.,* 156 F. Supp. 403 (D.C.N.Y., 1957), aff'd 267 F. 2d 333, also concerning withholding tax. These cases, all following *New York* v. *Rassner, supra,* hold that withheld tax funds constitute trust funds in favor of the taxing authority. Although the argument against allowing such statutory trusts to change the scheme of priorities in the Act is quite convincing,[8] we do not believe that question is present in this case. Whether or not these withheld funds constituted a trust fund for the benefit of the United States is rendered moot by the fact that the principal of the fund is not in issue here, and has in fact been paid over to the Government. As we have determined that the Govern-

[7] "(a) GENERAL RULE.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of the tax so collected or withheld shall be held to be a special fund in trust for the United States * * *."

[8] See Note 27, p. 2066, 3 Collier on Bankruptcy.

ment is not entitled to interest as here claimed, there are no further funds in issue, and thus no reason to reach the question as to whether or not a trust was so created.

For the reasons noted, the decree of the referee as adopted by the District Court is

Affirmed.

A true copy.

Attest: ROBERT C. TUCKER.

Clerk, U.S. Court of Appeals, Eighth Circuit.

JUDGMENT

United States Court of Appeals for the Eighth Circuit

No. 17780. September Term, 1964

UNITED STATES OF AMERICA, APPELLANT

v.

JEROME KALISHMAN, TRUSTEE IN BANKRUPTCY OF SEYMOUR WALLAS AND COMPANY, BANKRUPT

Appeal from the United States District Court for the Eastern District of Missouri.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Decree of the Referee in Bankruptcy as adopted by the District Court by its Order of April 21st, 1964, be, and the same is hereby, affirmed.

JUNE 4, 1965.

APPENDIX B

Bankruptcy Act, c. 541, 30 Stat. 544, *et seq.*:

Sec. 62 [as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840, 872, and Sec. 11(a), Act of June 28, 1946, c. 512, 60 Stat. 323, 329]. *Expenses of Administering Estates; Unauthorized Sharing of Fees; Withholding Allowances.*—a. (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * *

[11 U.S.C. 102.]

Sec. 64 [as amended by Sec. 1, Act of June 22, 1938, *supra* at 879, and Sec. 19(a), Act of July 7, 1952, c. 579, 66 Stat. 420, 426]. *Debts Which Have Priority.*—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * the costs and expenses of administration, * * *: *Provided, however,* That where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs

and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; * * *.

* * * * *

[11 U.S.C. (1958 ed.) 104.]

Sec. 342. [as added by Sec. 1, Act of June 22, 1938, *supra* at 909]. Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe.
[11 U.S.C. 742.]

Sec. 343 [as added by Sec. 1, Act of June 22, 1938, *supra*]. The receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.
[11 U.S.C. 743.]

Sec. 376 [as added by Sec. 1, Act of June 22, 1938, *supra* at 912, and amended by Sec. 8, Act of August 23, 1958, P.L. 85–732, 72 Stat. 820, 821]. If the statement of the executory contracts and the schedules and statement of affairs, as provided by paragraph (1) of section 324 of this Act, are not duly filed, or if an arrangement is not proposed in the manner and within the time fixed by the court, or if an arrangement is withdrawn or abandoned prior to its acceptance, or

is not accepted at the meeting of creditors or within such further time as the court may fix, or if the money or other consideration required to be deposited is not deposited or the application for confirmation is not filed within the time fixed by the court, or if confirmation of the arrangement is refused, the court shall—

(1) where the petition was filed under section 321 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

(2) where the petition was filed under section 322 of this Act, enter an order, upon hearing after notice to the debtor, the creditors, and such other persons as the court may direct, either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act or dismissing the proceeding under this chapter, whichever in the opinion of the court may be in the interest of the creditors: *Provided, however,* That an order adjudging the debtor a bankrupt may be entered without such hearing upon the debtor's consent.

[11 U.S.C. 776.]

Sec. 378 [as added by Sec. 1, Act of June 22, 1938, supra at 913]. Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 321 of this Act, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and

(2) in the case of a petition filed under section 322 of this Act, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered

on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 44 of this Act.

[11 U.S.C. 778.]

28 U.S.C.:

§ 960. *Tax liability*

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Internal Revenue Code of 1954:

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages a tax * * *.

* * * * *

[26 U.S.C. 3402.]

SEC. 3403. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of any such payment.

[26 U.S.C. 3403.]

SEC. 3501. COLLECTION AND PAYMENT OF TAXES.

The taxes imposed by this subtitle shall be collected by the Secretary or his delegate and shall be paid into the Treasury of the United States as internal-revenue collections.

[26 U.S.C. 3501.]

SEC. 3504 [As amended by Sec. 71, Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, 1660]. ACTS TO BE PERFORMED BY AGENTS.

In case a fiduciary, agent, or other person has the control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees, employed by one or more employers, the Secretary or his delegate, under regulations prescribed by him, is authorized to designate such fiduciary, agent, or other person to perform such acts as are required of employers under this title and as the Secretary or his delegate may specify. Except as may be otherwise prescribed by the Secretary or his delegate, all provisions of law (including penalties) applicable in respect of an employer shall be applicable to a fiduciary, agent, or other person so designated but, except as so provided, the employer for whom such fiduciary, agent, or other person acts shall remain subject to the provisions of law (including penalties) applicable in respect of employers.
[26 U.S.C. 3504.]

SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

* * * * *

(b) *Returns made by fiduciaries and receivers.*

* * * * *

(3) *Receivers, trustees and assignees for corporations.*—In a case where a receiver, trustee in bankruptcy, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver,

trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

* * * * * *

[26 U.S.C. 6012.]

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) *General Rule.*—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

* * * * * *

[26 U.S.C. 6601.]

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(b) *Penalties.*—

For penalties applicable to violations of this section, see sections 6672 and 7202.

[26 U.S.C. 7501.]

Treasury Regulations on Employment Tax (1954 Code):

§ 31.6071(a)–1 *Time for filing returns and other documents.*

(a) *Federal Insurance Contributions Act and income tax withheld from wages*—(1) *Quarterly or annual returns.* Each return required to be made under § 31.6011(a)–1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be made under § 31.6011(a)–4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve Bank.

* * * * *

[26 C.F.R., Sec. 31.6071(a)–1.]

§ 31.6151–1 *Time for paying tax.*

(a) *In general.* The tax required to be reported on each tax return required under this subpart is due and payable to the district director at the time prescribed in § 31.6071(a)–1 for filing such return. See the applicable sections of 26 CFR Part 301 (Regulations on Procedure and Administration), for provisions relating to interest on underpayments, additions to tax, and penalties.

(b) *Use of Government depositaries.* For provisions relating to the use of Federal Reserve banks and authorized commercial banks in depositing the taxes, see §§ 31.6302(c)–1 and 31.6302(c)–2.

[26 C.F.R., Sec. 31.6151–1.]

APPENDIX C

In the United States Court of Appeals for the Fifth Circuit

No. 21777

UNITED STATES OF AMERICA, APPELLANT

v.

JOHN NICHOLAS, TRUSTEE OF THE ESTATE OF BEACHCOMBER MOTEL, INC., BANKRUPT, APPELLEE

Appeal from the United States District Court for the Southern District of Florida

(May 25, 1965)

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges

TUTTLE, *Chief Judge:* On August 6, 1958, Beachcomber Motel, Inc., filed a petition for an arrangement proceeding under Chapter XI of the Bankruptcy Act. It was permitted to retain possession of the property as Debtor in Possession until, upon failure to submit an acceptable plan, the company was adjudicated a bankrupt on September 17, 1958. During the intervening period of operation, the Debtor in Possession failed to make payment of certain taxes that accrued during this short period of operation. In fact, under the statute, the taxes that were collected or withheld for the quarter ending September 30, 1958, were not required to be included in returns to be filed until October 31, 1958. Others were to be returned by January 31, 1959. By this time, of course, the Trustee in Bankruptcy had suc-

ceeded to the duties of the former Debtor in Possession.

The Trustee failed to make the required returns and the Government filed an administrative expense statement of the taxes due covering the following amounts: $519.89 of withholding and FICA taxes (Federal Insurance Contributions Act) accruing between August 6, 1958, when the petition for arrangement was filed and September 17, 1958, when the taxpayer was adjudicated a bankrupt; $644 of cabaret excise taxes also accruing between the same dates, and $362.29 of FUTA (Federal Unemployment Tax Act) accruing during 1958. The aggregate of these items is $1,526.18.

Additionally, the United States stated as administrative expense, assessed interest on each of the three principal items above set forth in the amounts of $101.54, $17.58, and $4.46, respectively, totalling $123.58. These two sums, $1,526.18 principal amount of tax and assessed interest of $123.58, totalling $1,649.76, were allowed by the referee as an administrative tax claim entitled to first priority.

However, the referee sustained the trustee's objection to the Government's claim No. 51 as to the amounts set forth as alleged penalties and accrued interest. Thus, the referee disallowed the following amounts contained in the Government's administrative expense statement of taxes due; namely, assessed penalty on the withholding and FICA taxes in the amount of $129.97, on the excise taxes in the amount of $161, and on the FUTA in the amount of $54.34, aggregating $345.31. The referee also disallowed interest after the date of the assessment and accrued to April 10, 1963 (the day before the date of filing of Claim No. 51) on the withholding and FICA taxes in the sum of $46.34, on the amount of excise taxes in the sum of $192.35, and on the amount of FUTA

taxes in the sum of $99.55, totalling $338.24. Claim No. 51 also sought interest on the amounts due at the rate of 31 cents per day from April 11, 1963, the date of the filing of the claim.

The referee, as already stated, allowed as an administrative expense entitled to a first priority the principal amounts of the taxes and assessed interest. Thus, the only controversy here is with respect to his disallowance of the items of assessed penalties totalling $345.31 and interest accrued after the date of assessment, totalling $338.24, in all, $683.55 together with interest from April 11, 1963.

Upon a petition for review filed by the United States from the disallowance of these penalties and interest, the District Court affirmed the order of the referee.

As the Government points out, the distinction between taxes which accrue against a taxpayer prior to bankruptcy and those which accrue against a trustee after bankruptcy, has become well settled. Pre-bankruptcy taxes are payable as tax claims against the bankrupt's estate under § 57 of the Bankruptcy Act. 11 U.S.C.A. § 93. They are entitled to payment as of the Fourth priority under § 64a of the Act, 11 U.S.C.A. § 104. If, however, a trustee becomes subject to taxes as a result of operations carried on after bankruptcy, these taxes constitute an expense of administration under § 62a of the Act and, as such, are payable as a First priority under § 64a.

The duty of the trustee in bankruptcy to pay taxes which accrue during the course of his administration, independent of tax claims which had accrued prior to bankruptcy, has long been recognized by the Supreme Court. See *Michigan* v. *Michigan Trust Co.*, 286 U.S. 334. Here, of course, the referee recognized this obligation, and properly required the payment of the principal amount of the taxes as an expense of admin-

istration. He drew the line, however, at the payment of interest on this principal amount of the taxes and additions to the tax, commonly called a penalty, arising from the failure of the trustee to make the necessary returns and payments on time.

The trustee here contends that since the taxes accrued while the Debtor in Possession was operating the corporation later to become bankrupt, rather than the trustee after bankruptcy, the taxes that accrued during this period should be treated as pre-bankruptcy taxes as should also, of course, the interest and penalties, if they are payable at all, when the failure to make the proper returns and payments is a failure of the bankruptcy trustee. As the Government points out, however, when a debtor is permitted to retain his possession under a Chapter XI arrangement proceeding, he is, within contemplation of the law, just like a trustee, certainly to the extent of his obligation and duty to do the things that the statute would require of a trustee in possession. In fact, where a plan for arrangement turns out to be unsuccessful and an adjudication of bankruptcy is entered, § 3782 of the Act provides that "the proceedings shall be conducted, so far as possible, in the same manner and with like effect, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this Chapter was filed; * * *" 11 U.S.C. § 778. See *United States* v. *Sampsell*, 9 Cir., 193 F. 2d 154. See also 8 Coll. on Bankruptcy (14 Ed. 1963 Rev. Secs. 6.31 and 6.32 which states "the general purpose of § 342 is that where a debtor continues in possession of his property, he shall be in fact a trustee. 'Its position as debtor, continued in possession, is for all practical purposes that of a trustee or receiver * * *'

'A debtor continued in possession by court order is a court officer anologous to a receiver or trustee.' A debtor in possession 'has all the powers of an ordinary trustee * * *'"

Thus, it is plain that the obligation of the trustee here was the same as if he had been in possession from the filing of the original Section XI proceedings. This being the case, it appears that the leading decision *Boteler* v. *Ingels,* 308 U.S. 57, answers the basic question whether the trustee is liable to the same obligation to make required returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face. We think it clear that he is so subject. The Supreme Court said in that case, "if businesses in California not conducted by a bankruptcy trustee are delinquent in the fees, they must pay the penalty. However, petitioners contention would exempt a trustee operating a business in bankruptcy from this double-tax liability which other delinquents must bear. A state would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment." (p. 61)

We conclude that the principle announced in the *Boteler* case clearly applies here to the federal impositions. Thus, it follows that the referee and the trial court erred in not including the items listed above as costs and expenses of administration and thus payable under the First priority.

The judgment is REVERSED and the case is REMANDED for further proceedings not inconsistent with this opinion.

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